

# ICPS newsletter<sup>®</sup>

## Critical changes to Ukraine's economic policy: recommendations from Ukrainian and US experts

*The US–Ukraine Economics and Business Task Force recommends that the Ukrainian Government change the system for making and implementing economic policy, speed up integration into the global economy, establish a favorable regulatory environment for business, stop cheating at state-owned companies, and improve tax legislation. The Task Force also proposes a number of specific steps to achieve these goals*

The US–Ukraine Economics and Business Task Force, which met in Ukraine 13–17 November 2005 as part of the “US–Ukraine Policy Dialog Exchange Program” project, has completed its second round. This two-year project includes a series of working sessions in Washington and Kyiv involving Ukrainian and American government specialists, lawmakers from both countries, and representatives of NGOs, business and the media. Its aim is to tackle key issues in Ukrainian–American relations. The working sessions of the US–Ukraine Economics and Business Task Force have been organized by the International Centre for Policy Studies. The Task Force also includes experts from the Ministry of Economy, the Ministry of Foreign Affairs, the Heritage Foundation, the RAND Corporation, and policy centers, and the SigmaBleyzer investment group.

The current session produced a series of recommendations for the Governments of Ukraine and the US. The steps the Task Force proposes reflect the results of debates that took place at the Centre and meetings with Deputy Economy Minister Valeriy Piatnytskiy and other Ministry experts, NBU Executive Director for Economic Issues Ihor Shumylo, NSC Deputy Secretary Vasyl Rohoviy, VR Deputy and Chair of the Council of Entrepreneurs Ksenia Liapina, State Investment and Innovation Agency Director Viktor Ivchenko, and the head of the Main Economic Policy Office of the Presidential Secretariat, Ludmila Musina.

These debates continued the process of developing recommendations that started in Washington 5–10 June 2005. According to the new report, the recommendations presented in June continue to be relevant.

### The old recommendations still matter

In June 2005, the Economics and Business Task Force made these recommendations:

- Create a uniform public vision of economic reforms for the president and the Government of Ukraine.
- Build institutional capacity in the Ukrainian Government for the implementation of radical, systematic and sustainable market reforms.
- Enhance property rights protection, strengthen the rule of law and reduce the tax burden.
- Increase integration into the global economy.

Since these recommendations were made, the Ukrainian Government has failed to make progress on them. Ukraine's dysfunctional economic policy-making process has led to chaotic policies that have discouraged entrepreneurs from investing in the country's economy and thus contributed to the economic downturn.

The November Task Force session developed specific economic policy recommendations for the Ukrainian Government and the US Administration for the next 4 months, based on its June statement.

### Set up a system for formulating and implementing economic policy

**Publicize a uniform public vision of economic reform.** The president, premier and VR faction leaders should issue a clear

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joint policy statement that the role of the Ukrainian Government is to create a free and competitive market environment in which the private sector can flourish. The Ukrainian Government should focus on efficiently providing public goods such as education, health care services, and infrastructure.

**Immediately consolidate all economic policy initiatives under one Cabinet committee in charge of economic policy, chaired by the premier.** This committee should have a trained, full-time staff that can prepare concept papers, draft legislation and work with the Verkhovna Rada to pass legislation. After legislation has been passed, this committee should develop an implementation plan and be responsible for its progress.

**Have the public administration task force issue policy papers on the transformation of public administration and initiate public consultations.** These papers should address the creation of a completely new system of public policy decision-making and implementation based on EU governance baselines. These include designing contract procedures and financial controls for competitive public procurement

to stop corruption and creating a responsive, effective, democratic civil service. It also includes thoroughly evaluating government activities and programs on the basis of their effectiveness, public interest and the relevant level—national, regional, or local—for providing public services.

## Promote integration into international trade systems

**Accelerate efforts to accede to the WTO and to establish a Free Trade Area with the EU by launching a public information campaign highlighting the benefits of free trade.** As long as Ukraine remains outside the WTO, Ukrainian farmers and manufacturers will face discrimination on foreign markets.

## Create a market-friendly regulatory framework

**Immediately request the Verkhovna Rada to abolish the current Commercial Code and to amend the Civil Code to be consistent with the best international examples.** Businesses in Ukraine operate in an unpredictable, chaotic legal environment because Ukraine has two contradictory codes that govern to business affairs: a Commercial Code styled on soviet-era laws, and more market-oriented but imperfect Civil Code.

**In the next 60 days, the Government should prepare a new draft law on joint stock companies based on EU standards and work with the Verkhovna Rada to pass the law.** Under the existing law, managers can easily rob companies of their assets and major shareholders can cheat minority shareholders.

**Immediately cancel excessive regulations based on the list proposed by the Council of Entrepreneurs under the Cabinet of Ministers.** Bring all remaining regulations into compliance with the new law on the system of permits, and enhance the effectiveness of one-stop shop procedures. Ukraine's regulatory system imposes enormous costs on businesses and fosters corruption.

**Adopt laws on the financial sector.** This includes such services as leasing, derivatives and other financial transactions, in accordance with the best OECD practices.

## Stop corruption at state-owned enterprises

**Managers of state-owned enterprises who are suspected of fraud should be immediately placed on leave, prosecuted and punished.** Some managers are looting their enterprises, stealing money and

property that belong to the people of Ukraine and costing the people of Ukraine billions of hryvnia each year.

**Establish a public inventory of all property owned by the state.** The Government should then transfer all state property, including that owned by the Presidential Secretariat and the Verkhovna Rada, to the State Property Fund and design a program to rapidly and transparently privatize these assets.

## Right the tax system

**Eliminate the tax on investment.** In March 2005, the Ukrainian government introduced a highly distorting VAT on imports of equipment that form a part of a foreign investment in Ukraine. This measure effectively imposes a 20% tax on foreign investment, discouraging investors and slowing economic growth. The Ukrainian government should eliminate this tax.

**Speed up customs clearance and VAT refunds to exporters.** The current system of VAT refunds to exporters is broken. By not refunding VAT to exporters, the Ukrainian Government steals money from businesses and prevents the expansion of exports investment and jobs.

**Decentralize the financing and provision of public services.** The Government should grant local authorities the right to levy and collect taxes.

## Facilitate the development of NGOs

The not-for-profit sector plays an important role in market economies and democratic societies, providing charity, encouraging policy debates, and contributing to the public good. Ukrainian not-for-profits are not allowed to generate revenues and their sponsors are taxed heavily, limiting the activities and the development of this sector. The Ukrainian Government should revise tax legislation to encourage the development of the not-for-profit sector.

## Recommendations to the US Government

**The US Congress should lift the Jackson–Vanik Amendment as it applies to Ukraine immediately.** There is no basis for applying the Jackson–Vanik amendment to Ukraine. The US Administration should work closely and actively with the Congress to lift the amendment immediately.

**The US Government should be more flexible in bilateral trade negotiations with Ukraine.** It should also encourage US Government agencies to work closely with

## *A new study should make it possible to evaluate the impact of government decisions*

ICPS, the Conference Board of Canada, an independent Canadian research organization, and specialists from the Ministry of Economy, the National Bank of Ukraine and the National Security Council have launched a joint project whose aim is to help introduce mechanisms for evaluating Ukraine's economic potential and the socio-economic impact of government decisions.

The participants plan to develop and introduce methods for evaluating potential output. They will also define key development indicators and monitor changes in these indicators.

Potential output is used by leading governments to identify inflationary pressure on a country's economy and to choose the right steps to curb price growth. When the components of growth are analyzed, it becomes possible to identify weak spots in the economy and potential in specific sectors. This means that changes in government policy can begin to be identified to stimulate the further development of economic processes.

The analysis of regulatory processes should make it possible to determine Ukraine's progress in key areas and to compare domestic indicators with other countries in Europe and around the globe.

This joint project between Ukrainian and Canadian specialists is slated to continue for three years, during which specialists from the Economy Ministry, the NBU and the NSC will be trained to identify and analyze potential output, to carry out comparative analysis, and to use analytical instruments to develop economic policy. Project tasks include the preparation of regular publications highlighting the results of the study and the ensuing recommendations.

Ukraine to provide financing, technical assistance and advice on achieving market economy status.

**Concentrate TA to Ukraine to implement the recommendations of the US–Ukraine Policy Dialog. ■**

*For more information about the “US–Ukraine Policy Dialog Exchange Program” project, visit us online at <http://www.icps.kiev.ua/eng/project.html?pid=94>. For additional information, contact Ihor Shevliakov by telephone at (380-44) 484-4400 or via e-mail at [ishevliakov@icps.kiev.ua](mailto:ishevliakov@icps.kiev.ua).*

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